Supreme Court of the United States.

OCTOBER TERM, 1890.

No. 55.

MORGAN'S LOUISIANA AND TEXAS RAILROAD AND STEAMSHIP COMPANY,
Appellant,

vs.

THE TEXAS CENTRAL RAILWAY COMPANY, THE FARMERS' LOAN & TRUST COMPANY, Trustee, and THE METROPOLITAN TRUST COMPANY of THE CITY OF NEW YORK, Trustee,
Appellees.

APPEAL FROM THE CIRCUIT COURT OF THE UNITED STATES FOR THE NORTHERN DISTRICT OF TEXAS.

BRIEF FOR APPELLANT.

J. HUBLEY ASHTON,
Counsel for Appellant.

McGILL & WALLACE
PRINTERS,
1107 E STREET N. W.

Supreme Court of the United States.

October Term, 1899. No. 55.

MORGAN'S LOUISIANA AND TEXAS RAILROAD AND STEAMSHIP COMPANY, APPELLANT,

vs.

THE TEXAS CENTRAL RAILWAY COMPANY, THE FARMERS' LOAN AND TRUST COMPANY, TRUSTEE, AND THE METROPOLITAN TRUST COMPANY, OF THE CITY OF NEW YORK, TRUSTEE.

Appeal from the Circuit Court of the United States for the Northern District of Texas.

Brief for the Appellant.

STATEMENT OF THE CASE.

This is an appeal by Morgan's Louisiana and Texas Railroad and Steamship Company, from the final decree in a suit instituted by it in the Court below, in which the appellees were defendants, to enforce its claim to an equitable mortgage or lien upon the property of the Texas Central Railway Company, which lien, it insists, is superior in right to the liens created upon the same prop-

erty by two mortgage deeds of trust, dated respectively September 15, 1879, and May 16, 1881, executed by the Texas Central Railway Company to the Farmers' Loan and Trust Company, as trustee, to secure certain issues of bonds.

The suit was begun on April 2, 1885, by a bill filed by Morgan's Louisiana and Texas Railroad and Steamship Company, a corporation organized under the laws of the State of Louisiana, and a citizen of that State, against the Texas Central Railway Company, a corporation organized under the laws of the State of Texas, and a citizen of that State, asserting the priority in right of the lien of the complainant upon the property of the defendant, alleging the insolvency of the defendant, and seeking the appointment of receivers to control and manage the property during the pendency of the suit. (Original Bill, Rec., pp. 1–13.)

On April 6, 1885, the Court appointed Charles Dillingham and Benjamin Clarke receivers of the property of the defendant, with authority to operate and manage its railways until further order of the Court. (Rec., pp. 45–48.)

On May 14, 1885, Morgan's Louisiana and Texas Railroad and Steamship Company, the complainant, exhibited an amended and supplemental bill against the Texas Central Railway Company, the original defendant, and against the Farmers' Loan and Trust Company of New York, trustee, a corporation organized under the laws of the State of New York, and a citizen of that State, and against the Metropolitan Trust Company of New York, trustee, a corporation organized under the laws of the State of New York, and a citizen of that State, reavering the matters alleged in the original bill, and alleging other matters as ground for the relief therein prayed. (Amended and Supplemental Bill, Rec., pp. 49, 50.)

The following is an abstract of the bills of the complainant:

The Original Bill.

The averments of the bill are mainly as follows:

The Texas Central Railway Company was originally organized and incorporated, under the general laws of Texas, on May 31, 1879, to build and operate a railway from Ross station, in McLennan county, to the centre of Eastland county, (the latter point being marked by the town of Cisco,) a distance of about 130 miles.

On or about May 12, 1881, its charter was amended so as to authorize it to extend its railway from the latter point to a point on the north boundary line of Texas, a distance of about 375 miles, and to construct also other branch roads.

The Company has built and owns a line of railway from Ross to Albany, at or near the centre of Shackelford county, a distance of about 176 miles, and also a line from Garrett, in Ellis county, to Roberts, in Hunt county, a distance of about 52 miles, making about 228 miles of railway in active operation.

On September 15, 1879, the Texas Central Railway Company executed to the Farmers' Loan and Trust Company, of New York, as trustee, a mortgage to secure the payment of a series of bonds of one thousand dollars each, to be issued by the mortgagor, covering its railroad, built and to be built, from Ross to Cisco, a distance of about 130 miles; the bonds to be payable thirty years after November 1, 1879, with interest at the rate of seven per cent. per annum, payable semi-annually on the first days of May and November in each year.

Bonds to the amount of $2,145,000 have been issued, and are outstanding, under this mortgage.

On May 16, 1881, the Texas Central Railway Company executed to the Farmers' Loan and Trust Company, as trustee, a mortgage to secure the payment of another series of bonds of one thousand dollars each, to be issued by the mortgagor Company, covering its entire main line of railroad, built and to be built, from Ross to the north boundary of Texas, and, also, its branch lines, as described; the bonds to be payable on May 1, 1911, with interest at seven per cent. per annum, payable semi-annually on the first days of May and November in each year.

Bonds to the amount of $1,254,000 have been issued, and are outstanding, under this mortgage.

On October 1, 1884, the Texas Central Railway Company executed to the Metropolitan Trust Company, of New York, as trustee, a mortgage of all its railways and railway lines, whether constructed, or to be constructed, to secure an issue of bonds, to be known as "general mortgage bonds" of the said Railway Company.

All of the bonds which the Texas Central Railway Company was authorized to issue, under this mortgage, have been signed and sealed, but the trustee refused and refuses to certify bonds thereunder, until the mortgage shall be recorded in all the counties of the State in which the same is required to be recorded. (Rec., p. 6, fol. 13.)

The Texas Central Railway Company, finding itself in great financial embarrassment, and requiring pecuniary assistance, and being already indebted to the Houston and Texas Central Railway Company in a very large amount, obtained further advances from that Company, making in all an aggregate indebtedness from the Texas Central Railway Company to the Houston and Texas Central Company of $761,992.04.

For the security of the said advances, then and theretofore made to it by the Houston and Texas Central Railway Company, the Texas Central Railway Company, on November 1, 1884, made and executed its sixteen (16) promissory notes, due on demand (fifteen for $50,000 each, and one for $11,992.04), and for the security of the said notes, pledged to the Houston and Texas Central Railway Company, a total amount of the said general mortgage bonds of $2,286,000, being the whole amount of the said general mortgage bonds which the Company was authorized to issue for the length of the road already built by it.

In order to make a pledge of said bonds, which were not yet countersigned and certified by the said trustee (the Metropolitan Trust Company), the Texas Central Railway Company issued and delivered to the Houston and Texas Central Railway Company its certificates in lieu of the said bonds, obligating itself to deliver said bonds as soon as executed and signed by the said trustee.

Due demand has been made for the payment of the said notes, but the Texas Central Company has refused and failed to pay the same. (Rec., p. 7, fols. 14, 15.)

The Houston and Texas Central Railway Company pledged the said notes, together with the certificates for the general mortgage bonds securing the same to the complainant, Morgan's Louisiana and Texas Railroad and Steamship Company, as part security for an indebtedness exceeding $1,000,000 due to it by the said Railway Company, and the complainant is the holder, as pledgee, of all of the said notes and certificates for bonds. (Rec., p. 7, fol. 15.)

The said deed of trust, with said certificates for bonds thereunder to be issued, constitutes a full, complete, perfect, and equitable mortgage and lien upon the railway

of the defendant, and the property in the said deed of trust described, in favor of the holder of the said notes and certificates for bonds.

The said advances by the Houston and Texas Central Railway Company to the Texas Central Railway Company, were made at various times for taxes, fuel, supplies, labor, repairs, operating and managing expenses, proper equipment, useful improvements, and other necessary expenditures, by which the defendant's railway has been kept in safe running order, its business and importance increased, and thereby rendered more beneficial to the bondholders under the mortgages described, and to all other creditors of the defendant. (Rec., p. 8, fol. 16.)

The said indebtedness was contracted by the defendant upon the consideration of its promise to pay the same out of the earnings of its railway, and the same was and is, in equity and good conscience, a first lien upon the income and property of the said railway, but the defendant, instead of paying the debt out of the earnings of the said railway, has failed to pay any part of it, and has used a large amount, at least $500,000, of said earnings, during the years 1882, 1883 and 1884, for the payment of coupons upon its first-mortgage bonds, although the holders of such coupons were only entitled to receive payment thereof after the defendant had paid the complainant the amounts advanced and expended in the manner and for the purposes in the bill set forth. (Rec., p. 8, fols. 16, 17.)

The defendant has no money, credit, or supplies, and the present gross total earnings of its railway are not equal to the operating expenses and reasonable maintenance.

Part of its pay-rolls for January, 1885, and all of its pay-rolls for February, 1885, are unpaid; those for March, 1885, when due, will not be paid; and the Company will default upon the interest of all its mortgage bonds, due May 1, 1885. The railway of the defendant Company runs through a new and undeveloped country, and one in which great financial depression at present exists, and unless it is administered in such manner as to maintain it with unimpaired efficiency, during this period of depression, its assets will be sacrificed without any adequate benefit to any of its creditors.

It is vitally important, not only to the complainant, but to all the lien creditors of defendant, and others having an interest in the property, that the property should not be dismembered, and the only means of preventing the dismemberment and preserving the integrity of the property, is through a receivership; and owing to the interdependence of the Houston and Texas Central Railway, and the Texas Central Railway Company, as mentioned, the receivers of the property of both Companies should be the same persons. (Rec., pp. 9, 10.)

The complainant prayed accordingly for the appointment of one or more receivers of the property of the defendant, and for a decree for the payment and satisfaction of its claims out of the net income in the hands of the receivers. (Rec., pp. 11, 12.)

The Amended and Supplemental Bill.

The material averments of the bill are as follows:

The Texas Central Railway Company is indebted to the complainant in the sum of $762,000, or thereabouts, which amount, as also the amounts due by that Company to others similarly situated, are equitable liens upon all the revenues of the Railway Company, and entitled to be paid out of the same before anything is paid to the

holders of the various mortgage bonds under the two several deeds of trust to the Farmers' Loan and Trust Company; and the said indebtedness is an equitable lien upon all of the property of the Railway Company, and entitled to be paid in case of sale out of the proceeds of sale before any money is paid to the holders of the said mortgage bonds. (Rec., p. 50, fol. 87.)

The said indebtedness should, and of right ought to, have been paid by the Railway Company out of its annual earnings, which were ample and sufficient to have paid all of said indebtedness.

Instead of paying the said debts incurred for labor, material, betterments and service necessary for the operation of the railway, and to keep the same in proper condition of repair and running order, the Railway Company expended its revenues in paying the interest on its said mortgage bonds, and leaving the complainant, and others similarly situated, unpaid.

They are entitled in equity and good conscience to stand in place and stead of the said mortgage creditors for the amounts they have so respectively received, and to have their claims satisfied out of the property of the Railway Company, or out of the proceeds of any sale thereof. (Rec., p. 50, fol. 87.)

The bill prays, among other things, for an accounting, a sale of the property, if necessary, and the payment of the amounts decreed to be due the complainant, out of the proceeds, in preference to any amounts due on the mortgage bonds, &c. (*Ib.*, pp. 51, 52.)

The Texas Central Railway Company, in its answer admits, in general, the allegations of the bill, and submits to the Court that none of the matters in the bills mentioned are matters in respect to which complainant is entitled to relief in a court of equity. (Answer, Rec., pp. 53–58.)

The Metropolitan Trust Company admits the allegations in respect to the mortgage executed to it, as trustee, on October 1, 1884, and that it refused to certify bonds thereunder until the completion of the recording of the mortgage. (*Ib.*, p. 59.)

The Farmers' Loan and Trust Company, in its answer on information and belief, denies the allegations of the bill in respect to the advances by the Houston and Texas Central Railway Company to the Texas Central Company, and says that if any advances were made, they were payments which should in equity be imputed to complainant, because of the facts set forth in the answer, as well as others, and denies that the indebtedness stated in the bill, was and is a first lien and charge upon the income or *corpus* of the property of the Company.

It also denies that the Texas Central Company has used a large amount of its earnings for making any payments of coupons upon its first-mortgage bonds, which payments the holders were not entitled to receive, and submits not only that complainant has no lien on the earnings or other property of said Company, but that complainant in equity is estopped from asserting any such claim. (Answer, Rec., pp. 62–69.)

The answer concludes:

"This defendant is advised and therefore alleges that the complainant has not, in its said original bill of complaint, or in its said amended and supplemental bill of complaint, made or stated such a case as entitles it in a court of equity to any discovery or relief against the defendants, and that the bills present no lien, or cause, or ground of equitable cognizance, or any ground for the appointment of a receiver of the defendant railway company. However, this defendant answers the said bills, praying, nevertheless, that it may have the same benefit and advantage as if it had specially *demurred* to the same." (Rec., p. 68.)

On November 2, 1885, the complainant filed its replications to the answers of the Farmers' Loan and Trust Company and the Metropolitan Trust Company. (Rec., pp. 69, 70.)

The so-called Cross-Bill.

The Farmers' Loan and Trust Company, on July 3, 1886, filed an application for leave to file its cross-bill, so called, in the suit, for the enforcement and foreclosure of the two mortgages executed to it by the Texas Central Railway Company, making as defendants therein the complainant and its co-defendants. (Rec., p. 72.)

Leave was granted by the District Judge, and on July 3, 1886, the Farmers' Loan and Trust Company filed its bill of complaint, praying for the appointment of a receiver to operate the Texas Central Railway, and for a decree of foreclosure, and sale of the mortgaged property, the proceeds to be applied to the payment of its costs, expenses, and compensation as trustee, and in discharge of the bonds and coupons secured by the deeds of trust, and for a personal judgment against the Railway Company for any deficiency. (Rec., pp. 73–83.)

The bill was filed by the complainant, as a citizen of the State of New York, against the Texas Central Railway Company, a corporation duly created by and under the laws of the State of Texas, a citizen of the said State, and against the Metropolitan Trust Company, of the city of New York, a corporation duly created by and under the laws of the State of New York, a citizen of the said State, and against Morgan's Louisiana and Texas Railroad and Steamship Company, a corporation duly created by and under the laws of the State of Louisiana, a citizen of the said State, and sets forth that it is filed as a cross-bill in the cause wherein Morgan's Louisiana and Texas Railroad and Steamship Company is complainant, and the other parties above named are defendants. (Rec., p. 73, folios 136, 137.)

The bill sets forth the mortgage of September 15, 1879, upon the main line of the Texas Central Railway Company from Ross to Cisco, and that complainant certified thereunder 2,145 bonds, aggregating $2,145,000 of principal, but states that, as to whether all, and if not all, how many, of the said bonds are outstanding, complainant has no positive knowledge. (Rec., p. 76, fol. 141.)

It also sets forth the mortgage of May 16, 1881, upon the extended main line of the Railway Company, as constructed, from Ross to Albany, and that complainant certified thereunder 1,254 bonds, aggregating $1,254,000 of principal, but states that as to whether all, and if not all, how many, of the said bonds are now outstanding, complainant has no positive knowledge. (*Ib.*, p. 78, fol. 144).

The bill avers that the mortgagor has failed to pay the interest on all the bonds secured by the mortgages respectively, which became due and payable May 1, 1885, and all interest since that date; that payment of such interest has been duly demanded; that said default has continued sixty days after such demand; and that thereupon the principal of all the bonds is and has become immediately due and payable. (*Ib.*, p. 79.)

The bill alleges that if any bonds, under the mortgage deed of trust to the Metropolitan Trust Company of October 1, 1884, are outstanding, the lien of the mortgage is subsequent and subsidiary to the liens of the mortgages made to the complainant, and that if the claim of the Morgan Company, as set forth in its bill, is a lien at all on the property, it is subject and inferior to the liens of the mortgages to the complainant. (*Ib.*, pp. 79, 80.)

The bill alleges that the Texas Central Railway Company is insolvent; that its indebtedness is so large that the Company, and its receivers, are utterly unable to pay the floating debt and discharge the interest on the mortgage bonds out of the net earnings; and that such state of affairs is likely to continue for an indefinite period.

It avers that until a judicial sale of the property can be had, and the proceeds distributed, it is expedient and necessary that all the rights, franchises, and property of the Company, continue to remain and be placed in the hands, and under control of receivers, with such powers over the same as to the Court should seem right and equitable to be conferred. (*Ib.*, p. 81, paragraph XX.)

The bill contains the usual prayers:

(*a*) Appointment of receiver.

(*b*) Injunction.

(*c*) Account of bonds secured by the mortgages, and amount due to the holders.

(*d*) Decree that the amounts so found due constitute a first lien on the property.

(*e*) Decree that the Railway Company pay into court the amounts of principal and interest of the bonds, together with costs, charges, and expenses of the suit, and compensation to complainant, and that in default of such payment the property and franchises of the Railway Company, should be sold to pay said principal and interest, with the costs and expenses as aforesaid, and the proceeds of sale to be applied to pay costs and expenses incurred by complainant in the performance of its trusts, and its reasonable compensation, and, in the next place, to the payment of the bonds and coupons secured by the said mortgages, and that the surplus may be applied as may be just.

(*f*) Decree barring defendants in this suit of and from any equity of redemption in the property and franchises as against both of the said mortgages.

(*g*) Judgment against the Texas Central Railway Company for any deficiency. (Rec., p. 82.)

The Texas Central Railway Company, in its answer, admits, in general, the allegations of the bill as to the

execution of the mortgages sought to be foreclosed, and states that all the bonds issued thereunder are outstanding.

The answer states that defendant does not admit that the claim of the Morgan Company was not well founded, and that as to whether the claim set up in the bill of that Company has a lien as therein claimed, and, if so, what are the respective rights of the complainant in that bill, and the complainant in the cross-bill, as between themselves, are questions of law which defendant submits to the Court. (Answer, Rec., pp. 104–107.)

Morgan's Louisiana and Texas Railroad and Steamship Company, in its answer, states that it reiterates all the averments in its original and amended bills contained, and claims that it has a lien upon the property of the Texas Central Railway Company, and that in any foreclosure proceeding, it is entitled to be paid out of the proceeds of sale, by preference over the mortgage creditors, the amount due to it from the said Company.

It avers that as all the revenues of the said Company, in the hands of the receiver, have been used by them for the betterment and improvement of the property, whereby the interests of the bondholders have been promoted and the value of the railroad increased, in case of foreclosure herein, it is entitled to an account of such revenues, as well as of the sums diverted from the current earnings to the payment of the interest, as prayed for in its bills.

The answer prays that in case of a decree of foreclosure, the Court will grant to defendant all the rights and claims set forth in its original and supplemental bills, all which matters and things being averred against the cross-complainant as fully as if the same were, in the answer, specifically set forth anew.

The defendant prays for all the relief prayed for in its said bills, and that all sums expended by the receivers

for the betterment of the railway may be decreed a lien upon the property paramount to the lien of the cross-complainant. (Answer, Rec., pp. 107–109.)

The Metropolitan Trust Company, in its answer, admits, in general, the allegations of the cross-bill respecting the mortgage executed to it, as trustee, by the Railway Company in October, 1884, and alleges that no bonds have, to its knowledge or belief, been issued secured by the lien of the said mortgage. (Rec., p. 110.)

Replications were filed by the Farmers' Loan and Trust Company to the answers of the Texas Central Company and the Morgan Company. (Rec., p. 109.)

The Proofs.

The Farmers' Loan and Trust Company, cross-complainant, on November 26, 1886, examined as witnesses in its behalf, W. D. Searls, Vice-President of the Company, and D. C. Moran, of Moran Brothers, brokers, who held a number of the bonds. (Rec., pp. 180–184.)

Cross-complainant offered in evidence, in connection with the testimony of Mr. Moran, a paper, dated New York, May 4, 1886, purporting to be a request, by owners, holders, or attorneys of the mortgage bonds of the Texas Central Railway Company, to the President of the Farmers' Loan and Trust Company, for the institution of proceedings to foreclose the mortgages, &c. (*Ib.*, p. 185.)

The paper (Exhibit E) was *objected to* by the counsel for the defendants, in the cross-bill, as *incompetent and immaterial, and as not sufficiently proved.* (*Ib.*, p. 182, fol. 356.)

Mr. Moran stated that, at the time his firm signed the paper, they "*held*" $1,241,000 of the bonds of 1909, and $127,000 of the bonds of 1911; but on cross-examination said that they "*actually owned*" only $347,000 of the bonds of 1909, and only $3,000 of the bonds of 1911. (*Ib.*, p. 183, fol. 359.)

The witness showed no authority from the owners of the bonds held, but not owned, by Moran Brothers, to sign a request for foreclosure on their behalf.

The paper (Exhibit E) does not purport to be signed by the holders of seventy-five per cent. in amount of the bonds of either issue; and no proof was offered of the signatures of several parties whose names are appended to the paper, or their authority to sign a request for foreclosure of the mortgages.

The evidence for the complainant, Morgan's Louisiana and Texas Railroad and Steamship Company, was adduced before the Special Master, on March 26, 1887. (Rec., pp. 114–125.)

Complainant offered in evidence the three mortgages referred to in its bill, and also the sixteen notes, amounting to $761,992.04, and accompanying obligations, of the Texas Central Railway Company mentioned in section 11 of the bill, in connection with the testimony of E. W. Cave, treasurer of that Company, and of the Houston and Texas Central Company, during the years 1880, '81, '82, '83, and '84, who produced and proved the resolution of the directors of the latter Company, pledging the said sixteen notes and obligations, to the Morgan Company, and the receipt of the latter therefor (Rec., pp. 143–145), and who testified that the said sixteen notes were given by the Texas Central Railway Company in settlement of its indebtedness for moneys theretofore advanced to it by the Houston and Texas Central Railway Company, in connection with the operation of its railroad. (Rec., p. 116.)

Mr. Cave verified a statement of the *gross earnings, operating expenses, taxes, and interest charges*, of the Texas Central Railway Company, from the time it commenced operations, covering the years 1880, '81, '82, '83, and up to September 30, 1884, which shows that the excess of

gross earnings, over operating expenses, pure and simple, and taxes, was only $241,558.55, while the interest on the *bonded debt*, amounted to $889,665, leaving a *deficit*, without interest, of *$648,106.51*. (Exhibit No. 6, Rec., p. 143.)

This deficit, with the interest thereon, made up $761,992.04 of debt, which represented the amounts advanced by the Houston and Texas Central Railway Company, to the Texas Central Railway Company, and for which the sixteen notes of the latter were given by it to the former Company.

The statement proved by Mr. Cave is as follows:

Exhibit No. 6.

TEXAS CENTRAL RAILWAY COMPANY.

Statement of Gross Earnings, Expenses of Operation, and Charges Against Income from Commencement of Operation to September 30, 1884, Inclusive.

	Gross earnings.	Operating expenses	Taxes.	Interest on bonded debt.	Total charge against income.	Deficit.
To Dec. 31, 1880.	$102 273 76	$75,360 25	$79 67	$54,250 00	$129,689 92	$26,916 16
" " 1881	247 707 02	115,426 83	3,603 24	140,875 00	259,905 07	12,198 05
" " 1882	205,887 32	157,936 73	9,629 79	218,650 00	386,203 52	180,316 20
" " 1883	230,262 45	248,810 73	13,440 32	237,930 00	499,681 05	269,418 60
" Sept. 30, 1884.	210,312 78	177,302 88	14,337 40	237,930 00	429,570 28	219,257 50
Total.....	1,056,943 33	774,297 42	41,087 42	889,665 00	1,705,049 84	648,106 51
Interest other than on bonded debt.....						70,098 85
Total deficit.....						718,205 36
						70,098 85
						648,106 51

The statement (Exhibit No. 6), it may be observed, shows upon its face that the moneys advanced to the Texas Central Company either went to pay *operating expenses* in lieu of earnings which were *diverted* by the Railway Company to pay *interest* to the mortgage bondholders, or were applied by the Company directly to the payment of *interest* to the mortgage bondholders.

Mr. Cave testified that all interest charges of the Company were paid up to the time it defaulted in 1885, and that if the advances of the Houston and Texas Central Company, represented by the notes referred to, had not been made, the road could not have been carried on, because the amount of gross earnings would have left a deficit upon its operating expenses and fixed charges that would have compelled it practically to stop. (Rec., p. 117, fol. 214).

On April 11, 1887, the cause was heard by Judge Pardee, presiding in the Circuit Court, and on April 12th, the Court rendered a final decree in the case.

The Decree.

The decree, after finding the execution and delivery to the complainant, The Farmers' Loan and Trust Company, of the two mortgages of September 15, 1879, and May 16, 1881, respectively, sought to be foreclosed by the bill of that Company, and the bonds entitled to the benefit of the security of those mortgages respectively, finds that on or about the first day of October, 1884, the Texas Central Railway Company made and delivered a certain other mortgage or deed of trust to the defendant, The Metropolitan Trust Company of the City of New York, to secure a series of bonds to be issued and to be known as general mortgage bonds of said Railway Company, and that said Railway Company did, by said general mortgage, grant and convey to said Metropolitan Trust Company all the property theretofore conveyed to the Farmers' Loan and Trust Company by the above mortgages, or either of them, but that the rights, liens, and claims of the said Metropolitan Trust Company, and the beneficiaries under its trust, so far as the same exist, are, in all respects, subsequent, subsidiary, and junior to the rights and equities of the cross-

complainant herein as trustee under the mortgages so made to the cross-complainant as aforesaid, and of the holders of the bonds to secure which the same were made respectively, both of the said mortgages to the cross-complainant, being prior liens to the said general mortgage—the first as to the property therein described, and the second as to the entire property of the defendant Railway Company. (Sec. X, Rec., p. 190.)

The decree then finds that the general mortgage bonds provided to be issued under said mortgage to the Metropolitan Trust Company of the City of New York, were duly executed and signed by the defendant Railway Company, and delivered to the said Metropolitan Trust Company for the purpose of having the said Trust Company certify the same as provided in the said mortgage, etc., and that the complainant herein, Morgan's Louisiana and Texas Railroad and Steamship Company, has an equitable lien upon all the property of the Texas Central Railway Company to the amount of $761,992.04, with six per centum per annum interest thereon from November 1, 1884, until paid, said lien, however, being junior and subordinate, in all respects, to the liens growing out of the mortgage deeds of trust of September 15, 1879, and May 16, 1881, to the Farmers' Loan and Trust Company, cross-complainant herein, upon the property of the said Railway Company. (Sec. X, Rec., p. 192; sec. XIV, *ib.*, p. 194.)

The decree further finds that the claim of the complainant, the Morgan Company, is, in all respects, subsequent and subsidiary and junior to the lien of the mortgages to the Farmers' Loan and Trust Company, and each of them, upon the property described in the said mortgages. (Sec. XIV, Rec., p. 194.)

The decree finds that in each of the said mortgages, it is provided that in case the defendant Railway Company shall fail to pay any of the interest on any of the

bonds, issued under the mortgage, at any time when the same may become due and payable, and such default shall continue sixty days after demand, then and thereupon the principal of all of the said bonds shall be and become immediately due and payable. (Secs. III, VII.)

The decree further finds:

"That the defendant, The Texas Central Railway Company, was on May 1, 1885, and still is insolvent and unable to meet or pay its obligations, including the coupons issued on its bonds secured by the said mortgages or deeds of trust to the Farmers' Loan and Trust Company, respectively maturing upon that day, and that it wholly failed to pay the same, and that it made default in the payment of all the said coupons which matured May 1, 1885, upon the bonds secured by the said mortgages or deeds of trusts, or either of them, and that it has not paid any of the said coupons maturing on either of said mortgages or deeds of trust which fell due November 1 1885, nor those which fell due May 1, 1886, nor any coupon which matured since that day, but that all the said coupon interest remains in default and overdue and unpaid; and, further, that payment of said interest has been duly demanded, and that such default has continued sixty days after such demand, and that *therefore the principal of all the said bonds secured by the said deeds of trust and each and all of them (including both the bonds of 1909 and the bonds of 1911) is and has become immediately due and payable.*" (Sec. XI, Rec., p. 192.)

The decree finds that the amount of principal and interest due on the bonds of 1909 is the sum of $2,533,554.85, and that the amount of principal and interest due on the bonds of 1911 is the sum of $1,481,974.13. (Sec. XII, Rec., p. 193.)

It then finds:

"That by reason of the default of the said Texas Central Railway Company to pay the said *coupon interest due as aforesaid, and any of it*, and by reason of other matters and things hereinabove alleged, the conditions of the said mort-

gages and deeds of trust of September 15, 1879, and May 16, 1881, and of each of them, made by the Texas Central Railway Company to the Farmers' Loan and Trust Company, have been broken, and that the said mortgages and deeds of trust, and both of them, have become absolute, and that the trustee is entitled to a decree for the sale of all the said mortgaged property to satisfy the principal and interest of the said bonds secured by the said mortgages or deeds of trust respectively, and all of them." (Sec. XIII.)

The decree then orders, adjudges and decrees that the principal sums specified in the said bonds, secured by the said mortgages to the Farmers' Loan and Trust Company, dated September 15, 1879, and May 16, 1881, respectively, and each and all of said sums have now become due and payable in accordance with the terms of the said mortgages. (Sec. XV., Rec. p. 194.)

It further orders and adjudges and decrees that the defendant, the Texas Central Railway Company shall, within ten (10) days from date, pay into court, for the use and benefit of the holders of the bonds and unpaid coupons secured by the said mortgages to the Farmers' Loan and Trust Company, the sum of $\$4,015,528\frac{98}{100}$ with interest thereon from the date of the decree at eight per cent. per annum, and also a sufficient sum to defray the costs of this cause.

And it is ordered, adjudged, and decreed that in default of such payment by the said Railway Company, or some one on its behalf, the equity of redemption of the defendant Railway Company, and of all the parties to this suit, and of all the holders of bonds or other claims issued under and secured by the said mortgage to the Metropolitan Trust Company of the City of New York, of, in, or to the mortgaged property, shall be barred and foreclosed, and that in default of such payment all the mortgaged premises and property shall be sold to the highest bidder for cash, as provided.

The decree requires the purchaser to pay, in cash, the costs of this suit to be taxed, and also the compensation of the Farmers' Loan and Trust Company for its services, charges and expenses in the execution of its trusts, respecting the mortgages, including its own compensation and its disbursements and allowances for solicitors' and counsel fees in the execution of its trusts respecting the mortgages and for services in this cause. (Sec. XVIII, Rec., p. 196.)

It provides that after paying off the claims entitled to be first paid out of the proceeds of the sale in cash, as set forth, the remainder of the bid, at the sale, may be paid either in cash or in bonds, or over-due coupons belonging thereto, secured by the said mortgages to the Farmers' Loan and Trust Company, the said bonds and coupons to be received at such price or value as will be equivalent to the distributive amount that the holders would be entitled to receive in case the entire amount of the bid were paid in cash. (Sec. XVIII, Rec., p. 196.)

It further orders that in case the amount of the bid shall be more than sufficient to pay the sums and amounts set forth, the amount of such overplus shall be applied to the payment of the sums decreed to be due to Morgan's Louisiana and Texas Railroad and Steamship Company.

The decree, also, orders, adjudges, and decrees that if the proceeds of the sale shall be insufficient to satisfy the sums adjudged in favor of the Farmers' Loan and Trust Company, and in favor of Morgan's Louisiana and Texas Railroad and Steamship Company, they shall have personal judgments and decrees against the Texas Central Railway Company for the balance that will remain due to them, respectively, over and above the proceeds of the sale, and shall have execution therefor. (Sec. XIX, Rec., p. 197.)

Morgan's Louisiana and Texas Railroad and Steamship Company has appealed from this decree.

Assignment of Errors.

The Court below erred:

1. In adjudging by the decree, herein, rendered April 12, 1887, that the equitable lien of the complainant and appellant upon the property of the Texas Central Railway Company, to the amount of $761,992.04, as ascertained by the said decree, is junior and subordinate in all respects to the liens growing out of the two mortgages of September 15, 1879, and May 16, 1881, executed by the said Railway Company to the Farmers' Loan and Trust Company.

2. In not adjudging that the debt due by the Texas Central Railway Company to the appellant, as set forth in its bills, and found by the said decree, in this suit, is an equitable lien upon the property of the said Railway Company prior and superior in right to the liens of the said mortgages to the Farmers' Loan and Trust Company, and entitled to be paid out of the proceeds of the sale of the said property in preference to the bonds secured by the said mortgages.

3. In not decreeing the payment of the claim of the appellant against the said Railway Company, set forth in its bills, and found by the decree, in this suit, out of the proceeds of the sale of the property of the said Railway Company, under the said decree, before any money is paid out of the said proceeds to the holders of the bonds or coupons secured by the said mortgages to the Farmers' Loan and Trust Company.

4. In granting leave to the Farmers' Loan and Trust Company to file the bill of complaint for the foreclosure of the said mortgages on the property of the Texas Central Railway Company, presented with its petition, filed July 3, 1886, and entertaining said bill, as a cross-bill, in this suit.

5. In not dismissing the said bill of complaint for want of jurisdiction and power to entertain the same, or to grant the relief prayed in said bill.

6. In rendering the decree of foreclosure and sale, entered in the said suit, on April 12, 1887, in accordance with the prayers of the said alleged cross-bill of complaint of the Farmers' Loan and Trust Company.

7. In decreeing the foreclosure of the said mortgages to the Farmers' Loan and Trust Company, trustee, and the sale of the property of the Texas Central Railway Company, to satisfy the bonds secured by the said mortgages, and all of them, the record not showing a request by the holders of seventy-five per cent. in amount of the bonds, outstanding under the mortgages, to the said trustee that it proceed to collect the principal and interest of the said bonds by foreclosure and sale.

8. In decreeing the foreclosure of the said mortgages to the Farmers' Loan and Trust Company, and a sale of the mortgaged property, upon the non-payment of the full amount of the principal and interest of the bonds secured by the said mortgages, respectively, within ten days from the date of the decree, without, and in the absence of, any averment in the said bill of the said Company, and of any proof, in this cause, of a request by the holders of seventy-five per cent. in amount of the said bonds, outstanding under the mortgages, to the said trustee, to foreclose the said mortgages, or to institute proceedings to foreclose the same.

Argument for the Appellant.

First.

The Priority of the Lien of the Appellant.

The first three assignments of error upon the decree below, present the question as to whether or not the claim of the Morgan Company, the original complainant, constitutes, in equity, a lien and charge upon the property of the defendant Railway Company, prior and superior in right to the lien of the mortgages to the defendant, the Farmers' Loan and Trust Company, and is justly entitled to be paid out of the proceeds of the sale of that property in preference to the mortgage bonds.

I. It is maintained and submitted, on the part of the appellant, that this question should be answered in the affirmative upon the principles settled in this Court by the case of *Fosdick* v. *Schall*, and the decisions which followed it on the subject of the relative equitable rights of mortgage and other creditors of an insolvent railroad company in respect to its property in the hands of a court of equity for administration as a trust fund for the payment of incumbrances, and that upon the authority of those adjudications the appellant is entitled to the relief asked in respect to the advances which constitute the basis of its claim in this suit. (Fosdick *v.* Schall, 99 U. S., 235; Hale *v.* Frost, *Ib.*, 392; Miltenberger *v.* Logansport Railway Co., 106 U. S., 311; Union Trust Co. *v.* Souther, 107 U. S., 594; Union Trust Co. *v.* Walker, *Ib.*, 596; Burnham *v.* Bowen, 111 U. S., 776; Union Trust Co. *v.* Illinois Midland Co., 117 U. S., 457; Porter *v.* P. S. Co., 120 U. S., 649; Penn *v.* Calhoun, 121 U. S., 251; Sage *v.* Memphis, &c., Railroad Co., 125 U. S., 361; St. Louis, &c., Railroad Co. *v.* Cleveland, &c., Ry., 125 U. S., 676; Union Trust Co. *v.* Morrison, 125

U. S., 591, 609, 612; Toledo, &c., R. R. Co. *v.* Hamilton, 134 U. S., 302. See, also, Blair *v.* St. Louis, H. & K. R. R. Co., 22 Fed. Rep., 474; Farmers' Loan and Trust Co. *v.* Vicksburgh, &c., R. R. Co., 33 Fed. Rep., 778.)

The decisions thus cited are so recent, and the doctrines declared so familiar to the Court, that it is unnecessary to present a detailed analysis of them, and it is requisite only to refer to the general principles which have been recognized and approved by the Court in those cases.

The authorities, taken together, may be regarded, we apprehend, as establishing, among others, the following propositions:

1st. The mortgage bondholders of a railroad company necessarily accept their security with the knowledge that the company, in the comprehensive and expressive language of Mr. Justice Harlan, is a "quasi public corporation operating a public highway," which is under an obligation to the State to keep up and maintain its railroad as a "*going concern*" and in a suitable condition, at all times, for performing the public service for which it was authorized to be constructed, and endowed with its faculties and franchises. (Barton *v.* Barbour, 104 U. S., 135; Union Trust Co. *v.* Ill. Mid. Co., 117 U. S., 454.)

2d. The holders of the mortgage bonds, as well as the public, are immediately interested in keeping up the property and preserving the business of the Company, and in accepting their security they must be deemed to assent to what is necessary to accomplish that object. (Galveston R. R. *v.* Cowdrey, 11 Wall., 459; Gilman *v.* Tel. Co., 91 U. S., 603; Bridge Co. *v.* Heidelbach, 94 *id.*, 798.)

3d. The underlying and controlling conditions and obligations affecting this peculiar species of property, as held in *trust for the public*, which have, in general, been adverted to, determine the rights of the mortgage bondholders in respect to the property and the income derived from its operations.

The fulfilment of the public obligations imposed upon a railroad company by the grant of its franchises is superior and paramount to, and, therefore, outranks, any claim of the bondholders to any portion of the earnings or receipts of the company.

The fund applicable to the payment of the interest on the mortgage bonds, is only the *net income* obtained by deducting from the gross earnings what is required for necessary operating and managing expenses, proper equipment, and useful improvement.

As this Court has said, a mortgagee is nothing more than a *creditor* secured by mortgage, which is but an incident to the debt it secures. (Myer *v.* Car Co., 102 U. S., 10.)

In *Union Pacific R. R. Co.* v. *U. S.* (99 U. S., 420), this Court, speaking by Mr. Justice Bradley, said:

> "*The bonded debt incurred for the purpose of construction and equipment is but another form of capital, analagous to preferred stock; and the interest accruing thereon is in the nature of a dividend on such capital.*"

4th. The officers of a railroad company are trustees of the earnings for the benefit of the different classes of creditors and the stockholders; and if, in the management of the affairs of the corporation, they give to one class of creditors that which properly belongs to another, a court of equity, when the property comes into its hands for administration as a trust fund, may, upon a restatement or readjustment of the accounts of the operations of the road, so use the earnings of the road, or the proceeds of a sale

of the *corpus* of the mortgaged property, in court for distribution, as to restore the parties to their original equitable rights.

5th. The mortgage security is thus chargeable in equity with the restoration of earnings, which, instead of having been applied to pay operating expenses and necessary repairs, have been diverted to pay interest on mortgage bonds, or the improvement of the property, the debts due for operating expenses having remained unpaid when a receiver was appointed.

6th. No fixed and inflexible rule has been, or can be, laid down for the government of the court, in the exercise of its equitable jurisdiction, in all cases involving the claims of creditors of insolvent railroad companies, otherwise unsecured, to outrank in priority of payment, upon a distribution of the proceeds of the *corpus* of the property, those who are secured by prior and express liens.

7th. Equity may require unsecured claims to be paid in preference to mortgage bonds, where there has been no diversion of earnings by the company to the benefit of the mortgagees.

In *Burnham* v. *Bowen* (111 U. S., 776), the claim of Bowen for coal furnished a year or more before foreclosure proceedings were instituted, was held, upon the facts in that case, to be a preferred lien upon the *corpus* of the property, and a sale was ordered if the claim was not paid by the trustees in possession, under strict foreclosure, although it appeared "that the expenses of running the road, and preserving the security of the bondholders, were greater than the receipts from the business." The late Chief Justice, delivering the opinion of the court, said:

"*The debt due Bowen was incurred to keep the road running and thus preserve the security of the bondholders.* * * * There is certainly no complaint of a *diversion by the company of the current earnings from the payment of the current expenses.* So far as anything appears on the record, the failure of the company to pay the debt to Bowen *was due alone to the fact that the expenses of running the road and preserving the security of the bondholders were greater than the receipts from the business.* Under these circumstances, we think the debt was a charge in equity on the continuing income, as well that which came into the hands of the Court after the receiver was appointed as that before. When, therefore, the Court took the earnings of the receivership and applied them to the payment of the fixed charges on the railroad structures, thus increasing the security of the bondholders at the expense of the labor and supply creditors, there was such a diversion of what is denominated in *Fosdick* v. *Schall* the 'current debt fund,' as to make it proper to require the mortgagees to pay it back. So far as the current expense creditors are concerned, the Court should use the income of the receivership in the way the *company would have been bound in equity and good conscience to use it if no change in the possession had been made.*"

8th. Money advanced to an embarrassed railroad company, without specific security, which was used directly in the payment of mortgage interest, the earnings, at the time, being insufficient to meet both interest and operating expenses, is entitled, upon the equitable principles which have been applied by the Court, in this class of cases, to be repaid out of the proceeds of sale of the mortgaged property in preference to the bondholders.

This proposition, as we suppose, is involved in the judgment of the Court in the case of *Penn* v. *Calhoun* (121 U. S., 251), where the Court found, as matter of fact, that the creditor expected to be paid out of the proceeds of the sale of bonds, given to secure the loan, and not from the earnings, and where the evidence failed to satisfy the Court that "any part of the money lent was used directly in the payment of mortgage interest."

If, in that case, the money had been advanced without security, and had been used for the purpose of paying mortgage interest, the decree, as we infer from the tenor of the opinion of the late Chief Justice, would have been in favor of the intervening creditor in the foreclosure suit.

The Chief Justice said:

"The evidence fails entirely to satisfy us that any part of the money lent was used directly in the payment of mortgage interest. * * * We are entirely satisfied that the Bank expected to be paid out of the proceeds of the sales of the bonds, and not from the earnings. * * * For its ultimate security the Bank relied on the indorsers of the note and the bonds, which were specially pledged for that purpose."

It would seem, as we have suggested, that if the facts had been as maintained by the creditor, in that case, his claim would have been allowed by this Court as a lien prior in right to the mortgage debt.

9th. A Court of Equity is invested with, and obliged to exercise, a large discretion in cases of this character, and has the right to extend equitable relief to those whose action and money, while the railroad was in operation, enured to the benefit of the bondholders, by charging the mortgage security with the payment of their just claims in the foreclosure proceedings.

This principle receives pregnant illustration in the decision of this Court in the case of *Union Trust Company* v. *Morrison*, 125 U. S., 591.

In that case, the rolling stock of the railroad company being in peril of seizure under a judgment against the company, the claimant had become surety in an injunction bond for the payment of the judgment if the injunction should be dissolved. After the dissolution of the injunction, the claimant intervened, in the foreclosure suit, for protection against the judgment recovered against

him on the injunction bond. The judgment having been, finally, paid by the claimant, it was held below, and this Court affirmed the decision, that he had a lien for the payment of the amount against the property sold under the decree of foreclosure, upon the broad equitable ground that the property in which the bondholders were interested was, in effect, rescued and saved to them by the act of the claimant.

The mortgage trustees, said Mr. Justice Bradley, speaking for the Court, stood by and saw Morrison "put his hands into the fire and rescue the rolling stock of which they were to receive the benefit—both directly, by receiving the property without contest or controversy, and *indirectly, by keeping up the railroad as a going concern. Morrison's money, or the fruits of it, has gone into their pockets.* And, in this regard, we make no distinction between the mortgagees, the bondholders whom they represent, the nominal purchasers, or the present company. They were all one and the same in interest." (125 U. S., pp. 609–10.)

It would seem to be plainly deducible from the authorities, that where a mortgaged railroad is in the hands of a Court of Chancery, in foreclosure proceedings, and it appears that advances were made to the company to enable it to pay the expenses of maintenance and operation, in lieu of moneys diverted from the earnings to pay bonded interest, or to enable it to pay such interest when there were no net earnings applicable to it, or when the net earnings were insufficient to meet the bonded interest, the mortgage security is chargeable with the payment of the debt for such advances in preference to the mortgage bonds.

Under such circumstances there should be a restatement of the account, and there must be charged against that which would otherwise go to the bond holders, such

amounts as they have received, which ought really to have been applied to the cost of maintaining and operating the road, or which were in excess of the amounts that upon a correct accounting they were entitled to receive in respect to the operations of the road.

Such advances constitute a debt of the mortgaged property, and are equitably entitled to be paid out of the proceeds of its sale in preference to any payment upon the mortgage bonds.

II. The principles thus adjudged by this Court entitle the appellant to the payment of its claim in respect to the advances to the Texas Central Railway Company set forth in the bill, and shown by the proofs, in this cause, and decreed by the Court below to be due to the appellant, out of the proceeds of the sale of the mortgaged property, before the mortgage bonds, and in preference to payment upon those bonds.

The aggregate amount of those advances, as shown by the testimony of Mr. Cave, and the statement (Exhibit No. 6) annexed to his deposition, was $648,106.51, which with interest thereon to November 1, 1884, amount to the sum of $761,992.04, represented by the sixteen notes delivered by the Texas Central Railway Company to the Houston and Texas Central Railway Company, and endorsed and pledged by the latter Company as part security for its indebtedness to the appellant, as stated in the testimony of Mr. Cave. (Rec., pp. 115, 143, 144, 145.)

(*a*) The advances made by the Houston and Texas were for the payment of operating expenses, taxes, and interest on the bonded debt of the Texas Central Railway Company, in 1880, 1881, 1882, 1883, and 1884, and constituted, in a large sense, the means by which it subsisted during the period embraced by the accounts, and by which the railroad property was kept and preserved

as a going concern for the use of the public and the benefit of the mortgage bondholders, and without those advances, the proofs show, the operations of the Company could not have been carried on, and the railroad would have stopped running almost as soon as it began to run.

The maintenance of the road and the prosecution of its business were essential to the preservation of the security of the bondholders.

As the advances directly enabled the Railway Company to maintain the integrity of the enterprise, and thus preserve the security of the bondholders, it is just, according to the equitable principles adjudicated by this Court, that they should be paid as a first lien upon the property.

(*b*) The Texas Central Railway appears to have been completed in the year 1880, and was operated by the Company until April 4, 1885, when the property was surrendered to the receivers under the order of the Circuit Court (Rec., pp. 143–147).

The testimony of Mr. Cave shows that, at the time the road was constructed, the country, into the centre of Bosque County, had experienced good crops, and was practically in a prosperous condition, but that afterwards bad seasons—bad crop seasons—were the rule upon a large portion of the line of the road between Morgan and Albany, and very many people were in a state of destitution, and required aid from the State.

These unfavorable conditions existed, as appears from the testimony of Mr. Cave, throughout the period covered by the advances of the Houston and Texas Central Railway. It was hoped and expected, however, that an improvement in the business of the road would take place, and that the Company would be enabled to reimburse the advances. (Rec., p. 117, fol. 216.)

The testimony of Mr. Cave in regard to the history of the enterprise is as follows:

"A large amount of the country is practically new and developed to its present extent largely by the construction and operation of the road. At the time when the road was constructed, the country into the centre of Bosque County had experienced good crops, and was practically in a prosperous condition. Since the construction of the road, bad seasons—bad crop seasons—have generally existed until within the past year upon a large portion of the line of the road between Morgan and Albany. Very many of the people have been in a state of destitution, and have required the aid of the State to maintain them through this period. I believe that if this condition changes, and it rains, that the country will improve; but a large portion of it is now occupied by several roads in competition with the Texas Central Railway, and this is to be considered as a factor in estimating the improvement of the business." (Rec., pp. 119, 120, fol. 222).

(*c*) Mr. Cave, as has been stated, testified to the correctness of the statement contained in *Exhibit No. 6*, annexed to his deposition (Rec., p. 143), showing the *gross revenues, operating expenses, taxes, and interest charges* of the Texas Central from the time it commenced operations, covering the years 1880, 1881, 1882, 1883, and up to September 30, 1884.

The statement discloses that while the total gross earnings of the Texas Central for four years and nine months, amounted to $1,056,943.33, the operating expenses and taxes aggregated $815,384.84, and the interest on the bonded debt amounted to $889,665, making the total charges against income $1,705,049.84, or, in other words, $648,106.51 *more* than the total gross earnings of the Company. (Rec., p. 143.)

During this period, the operating expenses were paid, as well as the bond-interest, but the Company was enabled to meet these obligations, from time to time, only through and by means of the advances of money made to it by the Houston and Texas Central Railway Company, upon which the present claim is founded.

That Company supplied the difference of $648,106.51, as above shown, between the amount of the operating expenses and fixed charges, and the gross income, of the Texas Central, and thus enabled the latter Company to keep up its road as a "going concern," during the period of depression referred to by Mr. Cave.

Mr. Cave says that all interest charges of the Texas Central Railway Company were paid up to the time when it defaulted on its interest, in 1885; that there was no year from 1880 up to September, 1884, when the Company earned enough to pay its operating expenses, and fixed charges, including taxes; that the funds advanced by the Houston and Texas Central Railway Company were used by that company in *paying its operating expenses, indebtedness accruing for material and supplies, for maintenance, and such things as had to be done to improve or keep the property up in proper condition, and there may have been some portion of the money that was necessarily applied to the maintenance of its security, i. e., the payment of interest on its bonds, because whatever money was used by the Company out of its own gross earnings from its general business for the payment of interest on its bonded debt necessarily left a deficit in its operating expenses and maintenance which had to be covered by advances and money obtained;* and that if the advances referred to had not been made, *the road could not have been carried on*, because the amount of gross earnings would have left a *deficit* upon its operating expenses and fixed charges, including taxes, that would have compelled it practically to have stopped. (Rec., pp. 116, 117, fols. 213, 214.)

(*d*) The testimony, also, is that the road was operated, practically, as a part of the Houston and Texas Central Railway, the latter Company collecting its revenues and accounts; that disbursements were made from the moneys collected; and that "*only* as the *deficit* arose and increased,

those advances were made and had to be made by the Houston and Texas Central Railway Company, and if they had not been made, the railroad would not have been run sometimes; it would have had to face debts it could not pay." (Rec., p. 122, fol. 229.)

The executive officers of the Houston and Texas Central Railway Company advanced the money, when and as needed, to pay operating expenses and interest, and paid it over to the Texas Central Railway Company, and its debts were paid, and receipts taken, &c. (*Ibid.*)

The moneys thus advanced by the Houston and Texas Central Railway Company, to supply these needs, from time to time, of the Texas Central, amounted, in the aggregate, to $648,106.51, when the Company suspended payment.

It thus appears, as we understand the testimony, that the advances were made by the elder Company to meet the particular *deficits* as they occurred, from time to time; to pay operating expenses, when there was a deficiency in the earnings; and to pay interest on the bonds, when there was no money, or not enough in hand from the earnings, to pay such interest.

When the Texas Central Railway Company wanted money for the purpose of meeting these obligations, the Houston and Texas Central Railway, as stated by Mr. Cave, "*let it have the money.*" (Rec., p. 124, fol. 234.)

The Texas Central furnished the money to pay the interest on its bonds, when it had funds, but when it did not have them, in the matter of interest, as in other matters, whatever balance was needed was supplied by the Houston and Texas Central Railway Company; but the Texas Central Railway Company paid its coupons, through John J. Cisco & Son, its fiscal agents in New York, after advertisement or notice, as usual. (*Ib.*, pp. 123, 124, fol. 232.)

The moneys were not put into any general fund in the treasury to be used with the rest to pay debts of the Company.

They were specific appropriations, as we understand, to meet particular deficiencies in the earnings, which it was necessary to supply, from time to time, in order to pay operating expenses, which were privileged debts, and interest on the bonded indebtedness, which was not properly payable until all the operating expenses were fully defrayed.

(*c*) The statement from the accounts (*Exhibit No. 6*) annexed to the deposition of Mr. Cave, the Treasurer, shows distinctly and clearly that the advances of the Houston and Texas Central Company either were used to pay operating expenses in the place of amounts diverted from the gross earnings to pay interest on the bonded debt, or were applied directly to the payment of that interest.

During no year of the operations of the Texas Central Company was it able to pay its operating expenses and interest charges out of its gross earnings. (See Statement, Rec., p. 143.)

In every case, if the amount of gross earnings was applied, in the first instance, to the payment of operating expenses and taxes, the remainder *fell short* of what was needed to pay accrued interest in sums ranging from $12,000 to $219,000 and over, as shown by the following abstract of the statement in the record:

Period Ending—	Interest on Bonds	Net Income.	Deficiency.
December 31, 1880	$54,250 00	$27,333 84	$26,916 16
December 31, 1881	140,875 00	128,676 95	12,198 05
December 31, 1882	218,680 00	38,363 80	180,316 20
December 31, 1883	237,930 00	28,511 40	209,418 60
September 30, 1884	237,930 00	18,672 50	219,257 50
	$889,665 00	$241,558 49	$648,106 51

The statement (*Exhibit 6*) shows, also, that for the year ending December 31, 1882, the interest charges amounted, as above, to $218,680, while the gross earnings were only $205,887.32—the interest charges thus *exceeding* the gross earnings by $12,792.68; and that for the period ending September 30, 1884, the interest paid on the bonds amounted to $237,930, while the gross earnings were only $210,312.78—the interest charges, during that period, thus *exceeding* the gross earnings to the amount of $27,617.22.

With regard to the advances included in the statement of account, it may be observed, generally, that so far as they were for the payment of operating expenses in lieu of gross earnings diverted by the Railway Company to pay interest on its bonds, and, also, so far as they were applied directly to the payment of such interest, the moneys advanced constituted the means whereby the Company was enabled to prosecute the undertaking for which it was chartered, and to satisfy the demands of the bondholders.

The officers of the Company, as said by this Court, in *Fosdick* v. *Schall*, were trustees of the earnings for the benefit of the creditors, as well as the stockholders; and their action bound the bondholders in respect to whatever arrangements were made by them in good faith for the purpose of keeping the road up, and paying the fixed charges, during the successive years of depression, bad crops, and bad seasons, as stated by Mr. Cave, which followed the construction of the railroad. (Rec., p. 120, fol. 222.)

(*f*) Applying the principle so often declared by the Court, in this class of cases, that gross earnings are lawfully applicable only to operating expenses, until these are fully paid, and cannot lawfully be diverted to the

benefit of the bondholders in payment of bond interest, and restating the account in respect to interest, it appears from the evidence, on the part of the appellant, to which reference has been made, that the bondholders, under the present mortgages, have received, in the way of interest from the Railway Company, $641,106.51 in excess of any legal or equitable claim they ever had on the income of the Company, and this through and by means of the advances claimed in this suit.

The proposition, therefore, is that as the advances were for the benefit of the bondholders, and their security, they constitute, in equity, a debt of the mortgaged property, which is justly and according to good conscience, payable out of the fund realized from that property, before any payment is made upon the mortgage bonds.

No distinction is to be drawn between advances which went to the payment of operating expenses, in lieu of earnings diverted by the Railway Company to pay interest, and moneys advanced for the payment of interest, and applied to that purpose, when, as appears, by the evidence, in the record, the net-income, out of which alone the interest was payable, was never, in any year, sufficient to meet the operating expenses and the fixed charges of the Railway Company.

The advances, as a whole, as has been said, constituted the *ways and means* of maintaining the good will and integrity of the enterprise, keeping the road up as a "going concern," and preserving the property, business and franchises for the advantage and benefit of the mortgage bondholders.

(*g*) All that was done, in these matters, by the elder Company, enured directly to the benefit of the public, and of the property in which the bondholders had so important an interest, and it is just and equitable, inasmuch as the expectations of the parties in regard to the enter-

prise were not realized, without any fault of theirs, that the mortgage security should bear the loss which must be sustained either by the bondholders or the appellant.

The loss, on the part of the former, in any event, as has been seen, would consist merely in restoring from their mortgage security the amount received in excess of what they were properly and equitably entitled to receive, by way of interest, upon a correct accounting in respect of the operations and earnings of the enterprise.

(*b*) The circumstances under which the present advances were made, the specific purposes for which they were made, the objects to which they were applied, and the results accomplished by them, take the advances out of the category of general, or floating, debts of an insolvent railroad company which cannot be allowed precedence, in the distribution of the proceeds of a sale of the property of the Company, over claims secured by prior and express liens.

III. It is unimportant, in any view of the rights of the appellant, involved in this cause, that, as stated by Mr. Cave, the Houston and Texas Central Railway Company owned about two-fifths of the capital stock of the Texas Central Railway Company, and that one-fifth of that stock was owned by Morgan's Louisiana and Texas Railroad and Steamship Company. (Mr. Cave, Rec., p. 117, fol. 215, p. 121, fol. 226.)

It has been often said, by this Court, that the stockholders are not the corporation, which is a separate, legal, or political person, distinct from the stockholders, whose property and rights of contract, or otherwise, belong to "the legal entity, the artificial being, created by the charter," and not to the individual members. (Bank of Augusta *v.* Earle, 13 Pet., 587; Pullman Car Co. *v.* Missouri Pacific Co., 115 U. S., 587; Porter *v.* Bessemer Steel Co., 120 U. S., 670).

As a stockholder, the Houston and Texas Central Company had the right to make these advances for the protection of the property and business of the Texas Central Railway Company, the same as other persons, and there is nothing in the relationship of the parties which can deprive the former of its equitable claim to reimbursement out of the proceeds of the mortgage security in preference to the holders of the bonds. (Twin-Lick Co. *v.* Marbury, 91 U. S., 589.)

The relations which subsisted between the Houston and Texas Central Railway Company and the Texas Central Company, and the transactions between the corporations, appear to have been entirely beneficial to the bondholders, and nothing seems to have been done by the companies owning a majority of the stock of the Texas Central Railway Company, in the exercise of any control over that Company, which can in any manner affect their equitable rights against the present property in respect to the advances claimed in this suit.

Second.

The Bill of the Farmers' Loan and Trust Company:

The fourth, fifth and sixth assignments of error are directed to the question of the right of the Court below to allow the bill of the Farmers' Loan and Trust Company to be filed as a cross-bill, in this suit, and the jurisdiction and power of the Court to entertain that bill, and render herein a decree thereon for the foreclosure of the mortgages to the complainant, and a sale of the property to pay the debt secured by the mortgages.

I. The replications of Morgan's Louisiana and Texas Railroad and Steamship Company, the complainant in this suit, to the answers of the Farmers' Loan and Trust

Company, and the Metropolitan Trust Company, were filed November 2, 1885, and the cause was thus at issue at that time. (Rec., pp. 69, 70.)

The application of the defendant, the Farmers' Loan and Trust Company, whose answer was filed September 24, 1885, for leave to file a cross-bill for the enforcement and foreclosure of its mortgages, was not filed until July 3, 1886; and on July 1, 1886, it appears, the District Judge granted the Company leave to file the bill exhibited by it, as a cross-bill in the original suit. (Rec., pp. 72, 73.)

The bill appears to have been filed July 3, 1886.

The rule of equity procedure is well settled that the proper time for filing a cross-bill, where such a bill is necessary, is at the time of putting in the answer to the original suit, and before the issue is joined by the filing of the replication. (2 Daniell's Ch. Pr., 1650.)

II. The subject-matter of the bill of the Morgan Company is its asserted equitable lien for the amount of the indebtedness set forth upon the property of the Railway Company, and the issues involved exclusively related to that claim.

The bill admitted the legal and express mortgages of the Farmers' Loan and Trust Company, and the bonds issued thereunder, and sought to obtain a decree for the payment of the claim out of the proceeds of any sale of the mortgaged property in preference to the payment of the bonds.

The answer of the Farmers' Loan and Trust Company purported to present a complete defence to the merits of the case made in the bill, and averred that the defendant was advised that good ground of *demurrer* to the bill existed, and prayed that, although it answered, it might have the same benefit and advantage as if it had specially demurred to the same. (Rec., p. 67, fol. 121, par. XXII; p. 68, par. XXV.)

The answer was, in fact, both an answer and a demurrer to the bills of the Morgan Company.

The defendant, in its bill to foreclose its mortgages, also averred that, in its answer, it had taken objection to the bill "for want of equity, and claimed priority therein for all matters and things set forth in the said bill of complaint." (Rec., p. 81.)

It was plainly not necessary to the defence of the Farmers' Loan and Trust Company to the claim asserted in the bill, or to a complete determination of the merits of that claim, that it should file a cross-bill for the foreclosure of its mortgages upon the property of the Railway Company.

III. It must be admitted that as an original bill, the Court below had no jurisdiction to entertain it, as the complainant, the Farmers' Loan and Trust Company, and one of the defendants, the Metropolitan Trust Company of New York, are citizens of the same State.

Section 738 of the Revised Statutes, providing for substituted service, by publication, against non-resident defendants, "in a suit in equity to enforce any *legal or equitable lien or claim* against real or personal property in the District where the suit is brought," does not give, or purport to give, jurisdiction to the Circuit Court, in such a suit, where the complainant and one of the defendants are citizens of the same State (Bringham *v.* Luddington, 12 Blatch, 241; Carpenter *v.* Talbot, 33 Fed. Rep., 537.)

In the former case Judge Woodruff said:

"Jurisdiction cannot be gained even by consent of parties; and where a suit cannot be sustained between the complainant and each of the defendants, the Court has no jurisdiction. (Strawbridge *v.* Curtis, 3 Cr., 267; Coal Co. *v.* Blatchford, 11 Wall., 172; R. R. Co. *v.* R. R. Co., 15 How., 233; Horn *v.* Lockhart, 17 Wall., 570.) The act of 1872 [Sec. 738, Rev. Stats.] does not prevent this result. It authorizes, in certain cases, the bringing in of

parties defendant not found within the District. It prescribes a substitute for service of process, but neither enlarges nor affects the jurisdiction of the Court over the action itself. If the Court would not have had such jurisdiction, had the defendant been found and served within the District, it cannot acquire such jurisdiction by order published as directed in the Act. Neither the Constitution nor the Judiciary Act of 1789, gives jurisdiction of an action where the complainant and one of the defendants are citizens of the same State."

As the bill for foreclosure of the Farmers' Loan and Trust Company sought to extinguish the equity of redemption of the Metropolitan Trust Company of the City of New York, as junior mortgagee, that Company was a necessary and indispensable party to the bill, or any bill for the foreclosure of the mortgages to the Farmer's Loan and Trust Company, seeking to divest its rights in the mortgaged estate. (C. & V. R. R. Co. *v.* Fosdick, 106 U. S., 88.)

Unless, therefore, the Farmers' Loan and Trust Company was entitled to file this bill, as a proper cross-bill, in the original suit, according to the principles applicable to such bills in the Federal Courts, the Court below erred in granting leave to file the bill, and in entertaining the same, and should have dismissed the bill for want of jurisdiction to consider it.

IV. It is submitted, on the part of the appellant, that the so-called cross-bill is not, and cannot stand, as a true or proper cross-bill, in this suit, within the jurisdiction of the Circuit Court by virtue of its jurisdiction of the original cause.

1. This Court has adopted Judge Story's definition: "A cross-bill, *ex vi terminorum*, implies a bill brought by a defendant in a suit against the plaintiff, or against other defendants, in the same suit, or against both,

touching the matters in question in the original bill." (Story Eq. Pl., sec. 389; Curtis, J., in Shields *v.* Barrow, 17 How., 145.)

In Ayres *v.* Carver (17 How., 591), this Court, speaking by Mr. Justice Nelson, again declared that a true cross-bill was a bill confined to the *matter in question in the original bill*, and was merely auxiliary to the proceedings on that bill.

Mr. Justice Nelson said: "The decree, whether maintaining or dismissing the cross-bill, disposes of a proceeding simply *incidental* to the principal matter in litigation, and can only be reviewed on an appeal from the final decree disposing of the whole case. That appeal brings up all the proceedings for re-examination, when the party aggrieved by any determination in respect to the cross-bill has the opportunity to review it, as in the case of any other *interlocutory* proceeding."

The decision of this Court, in the leading case of *Cross* v. *De Valle* (1 Wall., 14), is important upon the question now under consideration.

The Circuit Court had jurisdiction of the suit instituted by the original bill in that case; but some of the defendants, in that bill, filed what was called a *cross-bill* against the plaintiff and the other defendants. All the parties to both bills were the same, only that they were partially reversed; but, as the parties stood in the cross-bill, *each of the complainants could not, under the Judiciary Act, sue each of the defendants.*

The Circuit Court dismissed the bill, and also the so-called cross-bill.

It was admitted that if the second bill was not a proper cross-bill, the Court below had no jurisdiction of it, on account of the citizenship of the parties.

Very eminent counsel, the late Judge Curtis, maintained that the second bill was a true cross-bill; but this Court held otherwise, and that the Court below had no jurisdiction of the case made in the so-called cross-bill.

Mr. Justice Grier, delivering the opinion of the Court, said:

"The decree being in favor of Mrs. De Valle, and the bill dismissed, *the cross-bill must have the same fate with the original.* A cross-bill '*is a mere auxiliary suit, and a dependency of the original.* It may be brought by a defendant against the plaintiff in the same suit, or against other defendants, or against both, *but it must be touching the matters in question in the bill*; as where a discovery is necessary, or as where the original bill is brought for a specific performance of a contract, which the defendant, at the same time, insists ought to be delivered up and cancelled.' The bill filed by the heirs is for an entirely different purpose from that of Cross. It called upon the Court to decree on the future rights of their co-defendants, and others not *in esse*, and decree the limitations on the life estate to be void as tending to a perpetuity. *This would be introducing an entirely new controversy, not at all necessary to be decided in order to have a final decree on the case presented by the original bill.*"

In Rubber Co. *v.* Goodyear (9 Wall., 809), Mr. Justice Swayne, citing the previous cases defining a cross-bill, said: "It is auxiliary to the original suit, and a graft and dependency on it. If its purpose be different from this it is not a cross-bill, *though it may have a connection with the same subject.*"

2. It cannot be said, we think, that within these adjudicated definitions the present bill is a true cross-bill, a mere auxiliary or ancillary suit, a graft or dependency on the original bill, which is supported by the jurisdiction of the Circuit Court over the original suit, rendering it unnecessary that it should appear that the bill could be maintained, in that Court, as an original or independent suit for relief.

It is an obvious principle that where the parties defendant, or some of them, to a bill filed as a cross-bill, in the Circuit Court, are citizens of the same State with the

complainant, and the jurisdiction of the Court must depend upon the citizenship of the parties to the original suit, the Court must see that the bill is not for an independent measure of relief, and is *not* an original bill, or an original bill in the disguise of a cross-bill, for if it be, in any sense, an original or independent bill, it is not within the power of the jurisdiction of the Circuit Court.

It is an inflexible rule that the judicial power of the United States must not be exerted in a case to which it does not extend, even if both parties desire to have it exerted. (Railway Co. *v.* Swan, 111 U. S., 384.)

And the doctrine for which we contend is, that where the defendants, or some of them, to a bill filed in the Circuit Court as a cross-bill, are citizens of the same State with the complainant, the bill is to be deemed an original bill, and not a *cross-bill*, unless it appears, *1st*, that it is confined to the *subject-matter* of the first bill; *2d*, that it is *necessary* to the defence of the party; and *3d*, that it is merely *auxiliary*, or *ancillary*, to the original suit.

Tested by this principle, the bill in question is an original bill, and not a cross-bill which can be entertained by the Circuit Court.

(*a*) It is manifest that there is no identity between the subject-matter of the original bill of the Morgan Company, and that of the second bill of the Farmers' Loan and Trust Company, and that the second bill introduced a new matter, a new controversy, between the parties to the mortgages, sought to be foreclosed, not necessary to be decided in order to have a final decree on the case presented by the original bill of the Morgan Company to enforce its asserted equitable lien on the mortgaged property.

The subject-matter of the second bill, filed as a cross-bill, is the contract in the legal mortgages, and the asserted right of the trustee to foreclose the same for the

principal sum of the mortgage debt, on account of a default in the payment of the interest, which is a subject-matter not involved in the case presented in the bill of the Morgan Company, and aside and apart from the equities of that bill.

Whether or not the Farmers' Loan and Trust Company, as trustee, had the right, under the stipulations of the mortgages, to foreclose the same, as against the Railway Company, mortgagor, upon the grounds alleged in its foreclosure bill, is a matter foreign to the case for relief made in the bill of the Morgan Company, and, as we have said, not necessary to be decided to enable the Court to make a final decree, one way or the other, upon that bill.

(*b*) It is plain, moreover, that the cross-bill, so-called, in this record, is not necessary, or even important, to the defence of the complainant in that bill, against the claim of the Morgan Company to the possession of an equitable lien upon the railroad property, superior in right to the express lien of the legal mortgages, by virtue of the transactions set forth in its bill.

The rights of the parties in respect to the subject-matter of the original bill, can be completely determined upon the bill, and the answer interposed by the Farmers' Loan and Trust Company, without any cross-bill for foreclosure of the legal mortgages, or any adjudication of the rights of the parties to those mortgages, in the suit instituted by the original bill.

The right of foreclosure of the legal mortgages, asserted in the cross-bill, is a right entirely distinct from, and independent of, the right upon which the original bill was founded, and if the right exists, its enforcement is not necessary to the defence of the morgtagee, and its bondholders, as defendants in the original bill.

(*c*) The present cross-bill, so-called, is not, and cannot be treated as, merely auxiliary, or ancillary, to the bill of the Morgan Company, or an incidental or interlocutory proceeding in that suit.

It is manifest that this bill of foreclosure, so far from being a graft or dependency on the first bill, is to every legal intent and purpose, and in effect, an original and independent suit for relief, which took the usual course of an ordinary foreclosure bill in the Circuit Court from the beginning to the end of the litigation.

There is plainly nothing in the character, or contents, of the bill, which made it dependent, in any way, upon the fate of the bill of the Morgan Company.

Certainly, it must appear that the respective parties to a bill, filed as a cross-bill, in the Circuit Court, are citizens of different States, in every case in which the dismissal of the original bill would not carry the cross-bill with it.

It is the established doctrine of this Court, as we understand, that where the jurisdiction of the Circuit Court in respect to a supposed supplemental proceeding in an original suit, is sought to be sustained by the citizenship of the parties to that suit, it must appear that the proceeding is actually incidental and auxiliary to the original suit, and not really another litigation. (Bank *v.* Turnbull, 16 Wall., 195; Gwin *v.* Breedlove, 2 How, 35; Dunn *v.* Clarke, 8 Pet., 1.)

Third.

The Construction and Effect of the Mortgages.

The seventh and eighth assignments of error present the question, arising upon the construction and effect of the contract in the mortgages, as to the right of the Farmer's Loan and Trust Company, trustee, to proceed for their foreclosure and a sale of the property to pay the principal of the bonds, upon a default in the payment of interest, without averring and proving that

the bill had been filed for that purpose by the request of the holders of seventy-five per cent. in amount of the outstanding bonds.

I. The decree of April 12, 1887, as has been seen, finds that by reason of the default of the Texas Central Railway Company in paying the coupon interest on the mortgage bonds, which matured May 1, 1885, and subsequently, continued sixty days after demand of payment, the mortgages "have become absolute, and that the trustee is entitled to a decree for the sale of all the said mortgaged property to satisfy *the principal and interest* of the said bonds secured by the said mortgages, respectively, and all of them."

It then adjudges that the principal sums secured by the mortgages, respectively, have become "due and payable in accordance with the terms of the said mortgages," and that in default of the payment by the Railway Company, or some one on its behalf, within ten days, for the use and benefit of the mortgage bondholders, the full amount of the principal sum of all the bonds, under the mortgages, and interest, viz., $4,015,528.98, with interest at eight per cent. per annum, together with the costs of the suit, the equity of redemption of the Railway Company, and of all the parties to the suit, shall be barred and foreclosed, and the mortgaged property shall be sold, as provided in the decree.

Unless it appears that the principal sums had become *due and payable irrevocably for all the purposes of the mortgages*, on account of the default in the payment of interest, and the trustee had the right under the contract, at its option, to institute the present suit for the collection of the principal of the debt, as thus due, by foreclosure and sale, the decree below should be reversed.

II. The mortgage of September 15, 1879, after providing that it shall be void in the event that the Railway

Company shall pay the principal of the bonds and the several installments of interest as they become due, stipulates as follows:

"but in case the Texas Central Railway Company shall fail to pay the principle, or any part thereof, or any of the interest on any of the said bonds at any time when the same may become due and payable according to the tenor thereof, and if the said default shall continue sixty days after having been demanded, then and thereupon the principal of all the said bonds hereby secured shall be and become immediately due and payable, and upon the request of the holder or holders of seventy-five per cent. of said bonds then outstanding, and written notice of said request being served on the New York agency of the party of the first part, at which said bonds and coupons are made payable, the said trustee (who may act by its president or attorney), or its successor or successors in this trust, may and shall take actual possession (with or without entry or foreclosure) of said railway hereby conveyed, and of all and singular the said mortgaged property, and shall manage and operate the same and receive all the income and profits of the same, first defraying out of the same the expenses of the road and its needful repairs and the management of said trust, and the surplus to pay the interest and principal of all the bonds issued hereunder which may be due and outstanding and hereby secured *pro rata*, and upon the request of the holder or holders of seventy-five per cent. in amount of the bonds so in default which may be at any time outstanding under this deed of trust, it shall be the duty of the said Farmers' Loan and Trust Company, by its president or agent duly appointed in its behalf, to foreclose this mortgage or deed of trust and sell the property herein and hereby conveyed at the city of Houston, Texas, at public auction, to the highest bidder for cash," &c. (Rec., pp. 85, 86.)

The corresponding clause in the conditions of the mortgage of May 16, 1881, is, in the same words, as follows:

"but in case the Texas Central Railway Company shall fail to pay the principal, or any part thereof, or any

of the interest on any of the said bonds at any time when the same may become due and payable according to the tenor thereof, and if the said default shall continue sixty days after having been demanded, then and thereupon the principal of all the said bonds hereby secured shall be and become immediately due and payable; and upon the request of the holder or holders of seventy-five per cent. of said bonds then outstanding, and written notice of said request being served on the New York agency of the party of the first part, at which said bonds and coupons are made payable, the said trustee (who may act by its president or attorney) or its successor or successors in this trust, may and shall take actual possession (with or without entry or foreclosure) of said railway hereby conveyed, and of all and singular the said mortgaged property, and shall manage and operate the same and receive all the income and profits of the same, first defraying out of the same the expenses of the road and its needful repairs and the management of said trust, and the surplus to pay the interest and principal of all the bonds issued hereunder which may be due and outstanding and hereby secured *pro rata*. And upon the request of the holder or holders of seventy-five per cent. in amount of the bonds so in default which may be at any time outstanding under this deed of trust, it shall be the duty of the said Farmers' Loan and Trust Company, by its president or agent duly appointed in its behalf, to foreclose this mortgage or deed of trust and sell the property herein and hereby conveyed at the city of Houston, Texas, at public auction to the highest bidder for cash," &c. (Rec., pp. 93, 94.)

The contention, on the part of the appellant, is, that by the true construction of the foregoing conditions of the mortgages, the action of the trustee, in enforcing the stipulation that upon the prescribed default in the payment of the interest, the principal of the bonds shall become due, is subjected to the wishes of the bondholders, and the trustee is without right or power to institute proceedings for the collection of the principal sum of the mortgage debt, by foreclosure and sale, upon such de-

fault in the payment of the interest, before the day fixed by the credit, except upon the request of the holders of seventy-five per cent. in amount of the bonds outstanding under the mortgages.

1. The provisions of the mortgages, above quoted, should be construed in the light of the decision of the Court in the case of *Chicago and Vincennes R. R. Co. v. Fosdick*, (106 U. S., 77,) and the principles upon which it was founded.

The 8th article of the mortgage construed by the Court in that case, provided as follows:

"If default shall be made by the party of the first part in the payment of any half year's interest on any of said bonds, and the warrant or coupon for such interest shall have been presented, and its payment demanded, and such default shall have continued six months after such demand, without the consent of the holder of such coupon or bond, then and thereupon the principal of all of the said bonds hereby secured shall be and become *immediately due and payable*; and the said party of the second part may so declare the same, and notify the party of the first part thereof, and upon the written request of the holders of a majority of the said bonds then outstanding shall proceed to collect both principal and interest, by foreclosure and sale of said property, or otherwise, as herein provided."

The error assigned was that the Court below had decreed foreclosure and sale, on condition of the non-payment of the principal of the debt, as then due, without proof of the written request of the holders of the majority of the bonds, to the trustees, to institute proceedings to foreclose the mortgage.

The majority of the Court held that the assignment of error was well founded, and that had the trustees rightfully declared the principal sum of the mortgage debt due, and given the proper notice thereof, neverthe-

less, the foundation of proceedings to foreclose for that cause, and of the decree requiring payment of that amount, failed, without proof that the bill had been filed for that purpose, upon the written request of the holders of a majority of the outstanding bonds.

The minority of the Court were of opinion that the office of the clause in reference to the written request of a majority of the bondholders, was to make the obligation of the trustee imperative, instead of optional, and that the trustees were not precluded from instituting foreclosure proceedings, on their own motion, in case the safety of the trust made it necessary.

Mr. Justice Matthews, delivering the opinion of the Court, said:

"We cannot agree to that construction of the provision. The whole article must be taken together. And the nature of the provision and the character of its object must be taken into consideration as furnishing the rule of its interpretation. And while it is in the nature of a forfeiture, it is one against which, when it has taken place according to the fair meaning of the parties courts of equity will not relieve. The stipulation, nevertheless, is in the nature of a *penalty*, and may be regarded as *stricti juris*, to be construed fairly and reasonably, according to the meaning of the parties, but leaning, if need be, in any case of ambiguity, in favor of the debtor. * * * While, as we have seen one or any number of bondholders may prosecute a bill to foreclose the mortgage, upon a default as to payment of a single coupon, or the trustees may intervene on behalf of all for the same purpose, because the failure to pay a single installment of interest is made a breach of the condition of the mortgage; yet it is apparent that one purpose at least of the clause in question was to protect the bondholders as a class against the views of individuals and combinations of individuals, being a minority, pursuing separate interests. In declaring the principal sum due before the date fixed by the credit, upon a default in the payment of interest, the trustee is acting for the whole number of bondholders, and the provision that subjects his action in enforcing

the stipulation to the wishes of the majority, is meant, as we think, for the protection of the class. Many cases may be mentioned to illustrate the importance in their interests of such a control, rather than to put it in the power of one or a minority to require all to accept what the majority might consider to be a premature and less valuable satisfaction for their existing security."

In speaking of the other construction of the contract, Mr. Justice Matthews said:

"Indeed, the other construction contended for, which gives to the majority only the right to make the obligation of the trustee to proceed imperative, renders it nugatory. For upon that supposition, the debt *having become fully due, by the declaration and notice of the trustees, for all the purposes of the mortgage*, if they should delay or refuse to file a bill for foreclosure and sale, it would still be in the power of a single bondholder to proceed for himself and associates directly for the same object, and to procure the same relief."

The construction placed upon the mortgage, clearly was that the debt did not become actually due, for the purpose of foreclosure, until the written request of the holders of a majority of the bonds to the trustees for the institution of proceedings to foreclose the mortgage.

2. This Court has often said that the fundamental rule in the construction of all contracts is to ascertain "*the substantial intent of the parties.*" (15 Wall. 94.)

These mortgages show upon their face the intention of the parties that the principal debt was not to be treated as fully due for the purpose of collection out of the *corpus* of the mortgaged estate, on account of a default in the payment of the interest merely, until the holders of seventy-five per cent. of the debt desired to enforce the stipulation for its anticipated payment.

For the provision is express that it is only upon the request of the bondholders that the trustee shall FORECLOSE the mortgages and sell the property for the payment of the debt.

Until such request, the anticipated payment of the principal debt was not to be enforced by means of foreclosure.

Therefore, until such request should be made, the principal debt was not contemplated as irrevocably due for all the purposes of the mortgages.

The right to *enforce* the anticipated payment of the debt, in other words, was to attach *when, and only when the bondholders requested the trustee to proceed to foreclose the mortgages as against the corpus of the mortgaged estate, and not before.*

Indeed, the whole subject of the payment of the principal debt, after default in payment of the coupon interest, is left, and was intended to be left, by the mortgages to the wishes and discretionary decision of the holders of seventy-five per cent. in amount of the bonds.

It is only upon their *request* that the trustee can take *possession* of the property, receive the income, and pay the interest and principal of the bonds.

And it is only upon their *request* that the trustee shall "*foreclose*" the mortgages and sell the property for the payment of the bonds.

Nothing was to be done except "*upon the request*" of the bondholders as represented by the holders of seventy-five per cent. of the debt.

It was intended that they, and they only, should decide whether their interests, as respects the investment, required that the principal debt should be considered as fully due before the day fixed by the credit, and its payment anticipated and enforced by *foreclosing* the mortgages against the *corpus* of the mortgaged property.

This was undoubtedly the general, as well as the particular, intent of the parties contracting in these mortgages.

The view presented thus is that, by the true construction of the contract, the principal sum of the mortgage

debt is not absolutely due, for the purpose of a foreclosure of the lien against the *corpus* of the property, by reason of default in the payment of coupon interest, until the holders of seventy-five per cent. of the debt shall request the trustee to *foreclose* the mortgages.

In other words, the *right of action* for the principal debt, against the *corpus* of the mortgaged estate, does not *accrue* until the bondholders have requested the trustee to foreclose the mortgages.

3. It is thus seen that the indispensable *foundation* of any judicial proceeding to foreclose the mortgages and sell the property for the mortgage debt, upon the happening of a default in the payment of the interest, is a request for foreclosure by the owners of the amount of the bonds specified in the instruments.

As the mortgage debt is not fully due for the purposes of the mortgages, until the bondholders have requested the trustee to *foreclose* them, until then there can be no right of action *in rem* for the principal debt, and any bill, by the trustee, for foreclosure and sale for the payment of that debt, is without any legal foundation to sustain it.

The provision in regard to the request by the bondholders necessarily applies, in the view which has been presented, not only to the power conferred on the trustee by the mortgages, and the action of the trustee in execution of that power, but also to any judicial proceeding instituted by the trustee, to enforce the anticipated payment of the principal debt by foreclosure and sale of the *corpus* of the mortgaged property.

The provision, it may be observed, is the general and substantial provision in the contract conferring and governing the right of the trustee to *foreclose* the mortgages, on the failure of the company to pay an interest coupon, as mentioned in the instruments; and there is no reason

why its application should be confined, by construction, to the power of sale conferred on the trustee by the mortgages, whether the provision be regarded as one intended to favor the mortgagor, or as one designed for the protection of the bondholders.

That the stipulations in these mortgages, for the forfeiture of the time of payment, on the default of the company, continued for sixty days, to pay any installment of interest on the bonds, should be construed in any case of doubt, or ambiguity, in favor of the debtor, this Court has already, in effect, decided in the leading case of *Chicago & Vincennes R. R. Co.* v. *Fosdick*, above cited.

III. It proceeds from the views thus submitted that the foundation of the so-called cross-bill, and the present decree thereon requiring the payment of the whole debt secured by the mortgages, fails in the absence of any averment and proof, on the part of the complainant, of a request by holders of the bonds to the specified amount made to the trustee to institute proceedings to collect the principal of the bonds and interest by foreclosure and sale of the mortgaged property.

The evidence, on the part of the Farmers' Loan and Trust Company, failed to prove any request by the owners of a sufficient number of bonds of either issue to authorize the trustee to institute proceedings for foreclosure and sale of the property.

Seventy-five (75) per cent. of the respective amounts of the bonds, is of the bonds of 1909, $1,605,700, and of the bonds of 1911, $940,500.

The letter, dated May 4, 1886, annexed as *Exhibit E* to the deposition of Mr. Moran, and offered in evidence by complainant, subject to the objection of counsel for defendants that it was "*incompetent, immaterial, and not sufficiently proved*," purported to be signed by persons who purported to own, hold, or represent as attorneys, bonds,

due in 1909, to the amount of $1,315,000, and bonds due in 1911, to the amount of $127,000. (Rec., p. 185.)

If the paper had been properly proved by the production of the bonds in respect to which it was signed before the examiner, and the supporting testimony of the persons owning them, it could not be deemed, in any view, a sufficient compliance with the conditions of the mortgages.

It appears, affirmatively, from the testimony of Mr. Moran, the only signer who was examined by complainant, that his firm actually *owned* only a very small proportion of the bonds of each issue in respect to which it signed the letter, and no evidence whatever was adduced to show that the firm was authorized to sign a request for foreclosure on behalf of the owners of the bonds held, but not owned by it, and which the firm assumed, as would appear, to represent for that purpose. (Rec. p. 183, fol. 359.)

The mortgages plainly contemplate that a request to the trustee to foreclose shall be made by the *bona fide* owners, and not the physical custodians, of outstanding bonds to the amount prescribed in the instruments.

It is respectfully submitted that the final decree of April 12, 1887, should be reversed, and the cause remanded to the Court below with directions to dismiss the cross-bill of the Farmers' Loan and Trust Company, and enter a decree granting the appellant the relief prayed in its original and supplemental bills in this case.

J. Hubley Ashton,
Counsel for the Appellant.